

## Internal Revenue Service

Department of the Treasury  
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June 15, 2012

### LEGEND

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Business A =

State X =

Date 1 =

Date 2 =

a =

b =

c =

d =

e =

f =

g =

Dear :

This letter ruling responds to your August 30, 2011, request, submitted by your authorized representative, for rulings on certain federal income tax consequences of a proposed transaction. The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Proposed Transaction (defined below): (i) satisfies the business purpose requirements of Treas. Reg. § 1.355-2(b); (ii) is being used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

#### SUMMARY OF FACTS

Distributing is a State X corporation that was organized as a subchapter C corporation on Date 1. On Date 2, Distributing elected to be treated as a subchapter S corporation for federal income tax purposes. Distributing has one class of voting common stock authorized of which a shares are outstanding and owned by Shareholder 1 (b%) and Shareholder 2 (c%). Controlled is a State X corporation that is a wholly owned qualified subchapter S subsidiary (QSub) of Distributing. Distributing has submitted financial information indicating that Business A had gross receipts and operating expenses

representing the active conduct of a trade or business for each of the past five years. Distributing represented that payments were made to at least g employees for services rendered as employees of Distributing with regard to Business A. The employees of Distributing are paid through a payment service contract.

### PROPOSED TRANSACTION

For what are represented to be valid business reasons, Distributing has proposed the following transaction (the "Proposed Transaction"):

- (i) Distributing will contribute (the "Contribution"), approximately half of its assets to Controlled.
- (ii) Controlled will issue d shares of \$f par value common stock to Distributing in exchange for such assets.
- (iii) Distributing will redeem the e common shares owned by Shareholder 1 in return for the shares of Controlled (the "Distribution")
- (iv) Immediately after the Distribution, Controlled will elect to be treated as an S corporation pursuant to section 1362(a).

### REPRESENTATIONS

Distributing makes the following representations in connection with the Proposed Transaction:

- (a) The fair market value of the Controlled stock to be received by Shareholder 1 will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder 1 in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by a Distributing Shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its business.

- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to settle ongoing differences of opinion with regard to the development and management of Distributing's properties. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (g) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (h) The total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under section 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (i) The liabilities assumed (within the meaning of section 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (j) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Contribution.

- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (l) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (m) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (n) Distributing and Controlled will each pay their own expenses, if any, incurred in connection with the transaction.
- (o) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50-percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (p) Immediately after the transaction (taking into account section 355(g)(4)), either (i) no person will hold a 50-percent or greater interest (within the meaning of section 355(g)(3), in the stock of Distributing or Controlled who did not hold such an investment immediately before the transaction or (ii) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).

#### RULINGS

Based solely on the information submitted and the representations made, we rule as follows:

- (1) The Distribution will cause a termination of Controlled's status as a qualified subchapter S subsidiary because Controlled will cease to be a wholly owned subsidiary of an S corporation. For federal tax purposes, Controlled will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) from Distributing immediately before the Distribution in exchange for the stock of Controlled (the "Contribution"). Section 1361(b)(3)(B) and (C) and Treas. Reg. § 1.1361-5(b)(1).
- (2) The Contribution, together with the Distribution, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" under section 368(b).

- (3) Controlled will recognize no gain or loss on the Contribution. Section 1032(a).
- (4) Distributing will recognize no gain or loss on the Contribution. Sections 357(a) and 361(a).
- (5) Controlled's basis in each asset received from Distributing in the Contribution will equal the basis of such asset in the hands of Distributing immediately before the Contribution. Section 362(b).
- (6) Controlled's holding period in each asset received from Distributing in the Contribution will include the period during which such asset was held by Distributing. Section 1223(2).
- (7) Distributing will recognize no gain or loss on the distribution of the Controlled stock in the Distribution. Section 361(c)(1).
- (8) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder 1 on the receipt of the Controlled stock in the Distribution. Section 355(a)(1).
- (9) The basis of the Controlled stock in the hands of Shareholder 1 immediately after the Distribution will be the same as Shareholder 1's basis in the Distributing stock held immediately before the Distribution. Section 358(a)(1) and (b).
- (10) The holding period of the Controlled stock received by Shareholder 1 in the Distribution will include the holding period of the Distributing stock with respect to which the Distribution will be made, provided that such Distributing stock is held as a capital asset on the date of the Distribution. Section 1223(1).
- (11) The earnings and profits of Distributing, if any, will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. § 1.312-10(a).
- (12) The reorganization under section 368(a)(1)(D) will not adversely affect Distributing's status as an S corporation for federal tax purposes.

- (13) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled meets the requirements of section 1361(b)(1), it will be eligible to make an election under section 1362(a) to be treated as an S corporation for its first taxable year, provided such election is made effective immediately after the distribution of the stock of Controlled. Treas. Reg. § 1361-5(c)(2).
- (14) Any loss or deduction disallowed under Treas. Reg. § 1.1366-2(a) with respect to a shareholder of Distributing immediately before the transaction is allocated between Distributing and Controlled with respect to the shareholder. Such allocation shall be made according to any reasonable method, including a method based on the relative fair market value of the shareholder's stock in Distributing and Controlled immediately after the distribution.

#### CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the Proposed Transaction under other provisions of the Code or the regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) whether the Distribution is being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled, or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); (iii) whether the Distribution is part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii); (iv) whether Distributing or Controlled otherwise meets the requirements of a subchapter S corporation under section 1361.

#### PROCEDURAL MATTERS

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Isaac W. Zimbalist  
Senior Technician Reviewer Branch 5  
Office of Associate Chief Counsel (Corporate)

cc: